

**THE ALABAMA PREPAID AFFORDABLE COLLEGE TUITION PROGRAM  
MEETING OF THE BOARD OF DIRECTORS**

December 1, 2010

1:00 p.m.

**MINUTES**

**Present:**

Chairman Kay Ivey  
Mr. Bill Newton  
Dr. Greg Fitch  
Chancellor Freida Hill  
General Paul Hankins  
Dr. William Meehan  
Mr. Marc Green  
Dr. Richard Huckaby  
Mr. James Stubbs  
Ms. Patti Lambert  
Senator Roger Bedford

**Others Present include:**

Ms. Daria Story, Assistant Treasurer  
Ms. Brenda Emfinger, College Savings Programs Director  
Ms. Pam Stevenson, Assistant Director, College Savings Programs  
Mr. Mike Manasco, Board Legal Counsel  
Ms. Vickie Locke, Deputy Treasurer  
Mr. Bud Pellecchia, Callan Associates  
Ms. Annoesjka West, Callan Associates  
Mr. Dan Sherman, Buck Consultants  
Mr. Marcus Cleary, Buck Consultants  
Mr. Chad Bryan, Capell Howard

Pursuant to written and public notice, the regularly scheduled meeting of the Board of Directors of the PACT Program was held in the Board Room of the RSA Headquarters on December 1, 2010.

**Agenda Item I.**

The meeting was called to order by Chairman Kay Ivey at 1:00 p.m. Roll was taken with a quorum present. Chairman Ivey introduced Treasurer-Elect Young Boozer and welcomed him as the incoming Board Chairman.

**Agenda Item II.**

Chairman Ivey called for election of a Vice Chairman as required by the Bylaws adopted at the August board meeting. A motion was made by Mr. Newton, seconded by Dr. Meehan for nomination of General Hankins. There were no further nominations and General Hankins was unanimously elected Vice Chairman.

**Agenda Item III.**

The minutes of the August 26, 2010 board meeting were presented. A motion for approval was made by Dr. Meehan and seconded by Mr. Stubbs. The minutes were unanimously approved. Chairman Ivey informed the Board that Mr. Newton needed to leave early and requested a change in the order of Agenda items. Because Mr. Newton had requested a Rule change, she asked that Agenda Item V. (A.) be considered before the reports. There were no objections.

**Agenda Item V. (A.)**

Mr. Newton explained that he wanted to make the Rule regarding beneficiary substitution more restrictive, as it was at program inception, in order to save as many state funds as possible. He further explained that since the Legislature had provided funding, it was the Board's responsibility to do so. He stated that the Rule change would require that a beneficiary substitution not be allowed if any contract benefits had been utilized as opposed to the current Rule requiring 32 hours remaining for a substitution. Ms. Lambert expressed her opinion that this was a contract issue and that it would invite further litigation. She then asked about the financial impact of substitutions. Mr. Sherman, PACT Actuary, explained that of the 926 contracts where beneficiary substitutions had been made with fewer than 32 hours remaining, if you assumed 16 hours on each, the impact at the current rate of tuition per hour would be around \$3 million.

Dr. Huckaby then expressed his opinion that the Board still needed legal guidance on the difference between the Contract and the Rules. Dr. Fitch also expressed his opinion that if a beneficiary only went to college one semester and dropped out, the only benefit realized would be in canceling the contract and receiving a refund. At this point, Ms. Lambert made a motion to table the issue. The motion was seconded by Dr. Huckaby. With Ms. Lambert, Dr. Huckaby and Dr. Fitch voting yes, the motion failed by a majority vote of 5 voting no.

Ms. Lambert asked for an explanation of the Rule. Ms. Emfinger explained that from 1990 to 1998, the Rules did not allow a beneficiary substitution if any benefits had been utilized; and that over the years the Rule had changed to allow substitutions if 15 semester hours were remaining, then if one hour was remaining, then back to 15 and currently 32 hours. Mr. Manasco then reminded the Board that the current assets in the Trust Fund were assets from purchaser contributions and that no state funds would be in the Fund until 2015.

Chairman Ivey called the Board's attention to the Resolution approving the Rule change. After further discussion, a second motion was made by Dr. Huckaby and seconded by Ms. Lambert to table the issue in order to get more information. With 4 yes votes and 7 no votes, the motion failed.

The Resolution was then brought back for consideration. General Hankins offered an amendment to the last paragraph of the Resolution to say that the Rule would not take effect until 2015 when the first transfer was made from the Education Trust Fund. Chairman Ivey expressed her opinion that the Board should try to keep as much of the Fund assets as possible to assist with the state funding, and that this Rule change would do that. Senator Bedford expressed his opinion that all contract holders and the Legislature needed to be informed of the current status and the Rule change. Mr. Manasco was asked about the impact of litigation and Dr. Huckaby expressed his opinion that the Board should be more concerned about the Actuarial Report and should not make any further Rule changes unless they would have a significant cost savings without impairing the contract.

After further discussion, Dr. Fitch offered the following amendment to the Resolution in the last paragraph:

**BE IT FURTHER RESOLVED** that the 2010 Rule amendment shall not take effect until October 1, 2014 and only if the Trust Fund has sufficient funds to give refunds to all contract holders or the Trust Fund has sufficient funds to pay all benefits. Staff is directed to provide the Rules to the Council for consideration at its next meeting, and if approved, provide proper notification to all contract holders and the Legislature.

General Hankins withdrew his amendment and seconded Dr. Fitch's amendment and motion for approval of the Resolution as amended. Dr. Huckaby, Ms. Lambert, Mr. Stubbs voted no, Dr. Hill abstained, and Chairman Ivey, General Hankins, Dr. Meehan, Mr. Green, Dr. Fitch, Mr. Newton, and Senator Bedford voted yes. The motion adopting the amended Resolution was approved and is attached for reference.

#### **Agenda Item IV. (A.)**

Chairman Ivey called on Ms. Emfinger for the Program Report. Ms. Emfinger provided information on program statistics, contract cancellations and financials. She then informed the Board that based on the recently adopted asset allocation, assets had been successfully transitioned to the new managers, MacKayShields and Longfellow. She also discussed annual program information as well as PACT's procedure for processing invoices from the colleges/universities. The information is attached for review.

#### **Agenda Item IV. (B.)**

Chairman Ivey introduced Mr. Pellechia from Callan noting that he had worked with PACT in the recent past and was now part of the consulting team. She then called on him for the quarterly Investment Report. The Report is attached for reference. Mr. Pellechia provided summary information on managers and trust fund performance. He stated that the market value of trust fund assets at the end of September was \$487,290,736. This reflected an increase from the previous quarter. For the quarter ending September 30, the fund returned 5.12% with an annual return of 9.69% vs the target benchmark of 10.6%.

Mr. Pellechia then explained that the market value of assets on September 30, 2009 was \$526 million. The current balance of \$487.3 million resulted from liquidations to pay benefits and refunds of \$85.6 million with a positive investment return of \$46.9 million.

He then discussed asset allocation stating that asset allocation was slightly off versus the target asset allocation; equities were overweighted and fixed income underweighted, which had worked to the fund's advantage during the past quarter. Mr. Green asked about rebalancing and Mr. Pellechia explained that because of liquidations to pay benefits, rebalancing occurred with these withdrawals.

Mr. Pellechia then discussed quarterly manager performance. He stated that Rhumblin, the indexed equity manager performed in line with the index with a return of 11.54%. Principal, the international equity manager, had a quarterly return of 16.89% against the index of 16.58%. Western Asset had returns of 3.6% in the core fixed income mandate and 2.89% in the intermediate fixed income mandate. Sterne Agee returned 3.28% in the core mandate and 2.03% in the intermediate. The core fixed income benchmark returned 2.48% and the intermediate fixed income benchmark returned 2.44% for the quarter.

Mr. Pellecchia provided performance information for the month of October stating that the Fund was up \$7.9 million with \$3.3 million liquidated to pay benefits. The rate of return was 1.63% vs the index of 1.14%.

Mr. Pellecchia offered to answer any questions about previous decisions pertaining to the investments or asset allocation.

#### **Agenda Item IV. B (2.)**

Mr. Pellecchia asked Ms. West to discuss the proposed changes to the Investment Policy. Ms. West explained that with the newly adopted asset allocation, changes were needed and that going forward, annual changes would be necessary to accommodate the roll down equity strategy. She provided a summary of the changes along with a marked copy of the policy, which is attached for reference. She also discussed changes in manager guidelines that had been requested by the new fixed income managers, MacKayShields and Longfellow. Mr. Pellecchia explained Callan's process for reviewing requests from managers for changes to the guidelines.

Dr. Fitch asked if we should still be in an 80% allocation to fixed income and 20% to equities. Ms. West explained that because of the short time horizon for the Fund before assets would be depleted, it was necessary to focus on preserving the principal and maintain a more conservative asset allocation.

After discussion of the proposed changes, a motion was made by General Hankins to adopt the resolution approving the December 2010 Investment Policy and Guidelines as presented. The motion was seconded by Mr. Stubbs with unanimous approval. The Investment Policy and Manager Guidelines are attached for reference.

#### **Agenda Item IV. (C.)**

Chairman Ivey called on Mr. Sherman for the 2010 Actuarial Report. The report is attached for reference.

Mr. Sherman stated that as of September 30, 2010, the PACT Trust Fund had a deficit of \$268.8 million with a funded status of 77.5%. He began with a discussion of the change in the funded status from the September 30, 2009 report. On September 30, 2009, the deficit was \$345.7 million. The growth of that deficit based on interest was an increase of \$29.6 million and the additional funding from the Legislature mitigated the deficit by \$407.6 million. The unusually large tuition increase added a loss of \$132.4 million and the change in the actuarial assumptions accounted for a loss of \$148 million. A loss from other experience (eg. matriculation and cancellations) was \$24.6 million. The only other positive was an investment gain of \$3.9 million.

Mr. Sherman explained that the decrease in funded status from the June quarterly report of 100% was due to the realized tuition increases at the Auburn University and University of Alabama institutions, as well as the adoption of new assumptions for investment return and future tuition increases adopted by the Board at the August meeting. He further explained that the investment return assumption had been changed from 8.55%, in June 5%, to an annual average of 3% until the fund is expected to be depleted. The annual tuition assumption was changed from 7.45% to reflect annual increases at the two systems of 13%, 12%, 11%, 10%, 9%, 8%, and 7.5% thereafter. Mr. Sherman also noted that the majority of PACT students have been attending the Auburn and Alabama institutions.

Mr. Sherman explained the term "Current Tuition Value (CTV)" as the annual weighted average of tuition at the four year public universities, weighted by resident headcount. He stated that with the passage of Act 2010-725, the computation of the CTV was limited to the four year public universities, excluding the Auburn and University of Alabama institutions. Because of this, the rate per semester hour would not increase for several years.

Dr. Huckaby asked Mr. Sherman what had changed since the funding was provided by the Legislature which was to make the program fully funded. Mr. Sherman explained that the combination of double digit tuition increases at the Auburn University and the University of Alabama systems coupled with the new assumptions had outpaced the inflow of the future funding. He then stated that the only practical solutions would be to control tuition at all institutions or find additional funding or limit the payments to the beneficiaries.

Mr. Sherman provided information on the number of active contracts and explained the cash flow analysis. Based on the current market value of assets, the Trust fund will run out of funds in 2016. He then reviewed the analysis of benefit payments to the various categories of institutions.

General Hankins asked Mr. Sherman if he had considered other scenarios that might bring the fund back to a fully funded status. Mr. Sherman explained that several had been considered, including capping tuition at the Auburn University and University of Alabama systems. With a 7.5% cap on tuition at these institutions, the unfunded liability decreases to \$141 million and with a 5% cap, to \$14 million. The Board discussed their role as fiduciary, or a regulatory or political role. Senator Bedford stated that he did not see the Board in a political role but as a fiduciary with a responsibility to report and communicate with the Legislature. Dr. Meehan asked what cap would be necessary if all institutions had the same limitation and Mr. Sherman stated that it would be somewhere around 4%. The Board requested Mr. Sherman to run scenarios where the tuition would be capped at the same rate for all institutions and compute the loss to the institutions based on their standard nondiscounted published tuition. Dr. Hill also asked for an analysis of the impact if all students were required to attend a two-year college for the first two years.

Dr. Huckaby asked Mr. Sherman to determine the potential loss of tuition income to Auburn and Alabama if they were limited to a 4% increase in tuition. Mr. Sherman gave an estimate and agreed to come back with a more precise number.

#### **Agenda Item IV. (D.)**

Chairman Ivey informed the Board that Board Attorney and Treasury Legal Counsel Mike Manasco would be retiring in February. The Board expressed appreciation to Mr. Manasco for his service.

Chairman Ivey then called on Chad Bryan from Capell Howard for a legal report.

Mr. Bryan stated that the Perdue case in which Board members had been sued individually, had reached an amicable resolution on November 17 for a court approved settlement. He further stated that funds from Risk Management would be paid into the Court and that the case would be dismissed with prejudice.

He then explained that Green II was a class action lawsuit with a decision pending on class certification. He stated that most likely one class would be certified with sub classes and that

once the certification was approved, all contract purchasers would be notified by postcard and via the website. He stated that discovery would begin in December and January.

He then briefed the board on the pending suit challenging the constitutionality of Act 2010-725, stating that no hearing had been held but a motion had been filed to dismiss.

Senator Bedford expressed his concern over legal cost and asked for an executive session at the February board meeting to discuss the status of the lawsuits.

Mr. Manasco added that the Green case had shifted from a concern over tuition to mandatory fees in terms of how they were defined and which were paid or not paid.

#### **Agenda Item IV. B. (2.)**

Mr. Manasco called the board's attention to information asking to submit a request for an Attorney General's opinion to interpret certain provisions in Act 2010-725. He explained that Troy University had sent a letter to the Treasurer with an Attorney General's Opinion concerning the determination of the Fall 2009 tuition rates. He explained that the issue arose because Troy University froze their tuition rates for PACT students at the 2008 rates. Because the rate was frozen in 2009, Troy requested the opinion to be able to base their Fall 2009 rates on the "standard, nondiscounted, published" tuition rates rather than the discounted rate that was charged to PACT students.

Mr. Manasco then reviewed the issues to be addressed in an Opinion which included the definition of tuition, establishment of tuition rates when the funding status falls below 90% and the determination of fees to be paid. The information is attached for reference.

Chairman Ivey called the Board's attention to the Resolution approving the submission of the request. She requested that the last word in the Resolution, "immediately", be struck. With no objection to the striking of "immediately", a motion was made by Senator Bedford to adopt the Resolution. The motion passed unanimously.

Ms. Emfinger asked for direction concerning the payment of the Fall 2010 invoice for Troy University. It was the consensus of the Board to make the payment at the PACT 2009 rates pending receipt of the Attorney General's Opinion.

#### **Agenda Item V. (B.)**

Chairman Ivey called on Ms. Emfinger to discuss the proposed changes to the Disclosure Statement. Ms. Emfinger discussed the changes, noting that most changes resulted from Act 2010-725 and the addition of disclosure of risk. The documents are attached for reference. General Hankins asked if legal counsel had reviewed and was told that it had been a joint effort with Mr. Manasco. A motion was made by Senator Bedford, seconded by General Hankins for approval of the Disclosure Statement as presented. The motion unanimously passed.

#### **Agenda Item VI.**

Chairman Ivey called the Board's attention to information provided by the College Savings Plans Network, as well as board meeting dates for 2011.

Senator Bedford expressed appreciation to Treasurer Ivey for her service on the Board, and congratulated her on her election as Lieutenant Governor.

There being no further business, the meeting was adjourned at 4:10 p.m.

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Brenda Emfinger, Recording Secretary

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Young Boozer, Chairman